

Message Text

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ACTION EB-07

INFO OCT-01 EUR-12 ISO-00 GSA-01 ERDA-05 AID-05 CEA-01

CIAE-00 CIEP-01 COME-00 DODE-00 FEAE-00 FPC-01 H-02

INR-07 INT-05 L-03 NSAE-00 NSC-05 OMB-01 PM-04

USIA-06 SAM-01 OES-03 SP-02 SS-15 STR-04 TRSE-00 PA-01

PRS-01 /094 W

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R 031808Z FEB 76

FM AMEMBASSY LONDON

TO SECSTATE WASHDC 8690

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E.O. 11652: N/A

TAGS: EMIN, ETRD

SUBJECT: COPPER -- OWNERSHIP OF LME STOCKS

REF: (A) LONDON 133; (B) STATE 531

1. LONDON METAL EXCHANGE (LME) WAREHOUSES (WAREHOUSES IN THE UK AND ON THE CONTINENT APPROVED BY THE LME FOR HOLDING METAL TRADED) REPORTEDLY NOW HOLD MORE THAN 500,000 TONS OF COPPER METAL VALUED AT ROUGHLY 300 MILLION POUNDS STERLING. THIS IS APPROXIMATELY ONE-THIRD OF THE WORLD'S SURPLUS. IN RESPONSE TO REF (B), THIS CABLE PROVIDES THE EMBASSY'S BEST ESTIMATE OF THE OWNERSHIP OF THESE STOCKS, BASED ON A NUMBER OF CONVERSATIONS WITH LME SOURCES. AT BEST, THE ESTIMATES ARE NOTIONAL, SINCE, AS ON ANY COMMODITY MARKET, OWNERSHIP CONSTANTLY SHIFTS. MOREOVER, NO ATTEMPT AT CENTRALIZED RECORD KEEPING IS MADE BY THE LME OR THE BRITISH GOVERNMENT.

2. FOR THE PURPOSE OF ANALYSIS, OWNERSHIP MAY BE DI-

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VIDED INTO THREE MAJOR GROUPS:

- (A) THAT HELD BY COPPER MERCHANTS (LME BROKERS) --
ABOUT 15 PERCENT, PROBABLY LARGELY BANK FINANCED
- (B) PRODUCER/CONSUMER COPPER -- SOME 60 PERCENT, ALSO
HEAVILY FINANCED BY BANKS
- (C) INVESTOR-SPECULATORS -- ABOUT 25 PERCENT. IN
CONTRAST TO THE FIRST TWO GROUPS, THIS GROUP
HAS LITTLE CONNECTION WITH THE INDUSTRY AS SUCH.
IT CONSISTS OF INDIVIDUALS AND INSTITUTIONS WHO
HOLD PHYSICAL COPPER FOR SPECULATION OR LONG-
TERM CAPITAL GAIN.

3. OF THE THREE GROUPS, THE FIRST TWO ARE ESSENTIALLY THE SAME. ALTHOUGH WARRENTS FOR THE COPPER THEY ORIGINALLY POSSESSED MAY HAVE PASSED TO LONDON MERCHANT BANKS IN THE SHORT-TERM, A SIMILAR AMOUNT OF METAL IS NONETHELESS COMMITTED TO THEM VIA THE FUTURES MECHANISM. THE RESULT IS THAT THESE TWO GROUPS HAVE NOT RELINQUISHED THEIR CLAIMS TO METAL AT SOME TIME IN THE FUTURE. LITTLE IS KNOWN ABOUT THE THIRD GROUP, AND LME MEMBERS FEAR THAT THIS GROUP COULD PROVE QUITE VOLATILE. POTENTIALLY, IT COULD HAVE A SERIOUS DESTABILIZING EFFECT ON THE MARKET.

4. AS NOTED ABOVE, MUCH OF THE COPPER IN THE WAREHOUSES IS BENEFICIALLY OWNED BY BANKS. BANKS BUY METAL AT THE CASH (OR SPOT) PRICE ON THE LME AND SIMULTANEOUSLY SELL IT BACK FOR FUTURE DELIVERY. A BANK TRADING IN THIS FASHION IS ASSURED A SPECIFIED EARNING THROUGH THE "CONTANGO", THE AMOUNT BY WHICH THE FUTURES PRICE -- CONTRACTS ARE FOR THREE MONTHS OR LESS -- IS ABOVE THE PRESENT PRICE. AT THE SAME TIME, THOSE MOST DIRECTLY CONCERNED WITH PRODUCTION, COMMERCIALIZATION AND PROCESSING OF COPPER HAVE COVERED THEMSELVES BY FUTURES PURCHASE CONTRACTS. THIS APPEARS TO BE A RELATIVELY SIMPLE AND SAFE FINANCING PROCEDURE, BUT OF COURSE IT IS VIABLE ONLY UNDER A SET OF FAIRLY LIMITED CONDITIONS. CLEARLY, SHOULD THE CONTANGO BECOME TOO WIDE OR TOO NARROW THIS PARTICULAR FINANCING METHOD WOULD LOSE ITS ATTRACTIVENESS.

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5. THIS SYSTEM HAS BEEN WELL SUITED TO THE NEEDS OF BOTH PRODUCERS AND CONSUMERS. UNDER PRESENT WORLD MARKET CONDITIONS, PRICES ARE CONSIDERED LOW, BUT PROSPECTS ARE THAT TODAY'S GLUT WILL DISAPPEAR NOW THAT THE WORLD RECESSION SEEMS TO BE BOTTOMING OUT. EARLY RECOVERY IN THE UNITED STATES, OF COURSE, IS PARTICULARLY IMPORTANT. IN THE INTERIM, HOWEVER, BOTH PRODUCERS AND CONSUMERS HAVE FELT IT NECESSARY TO INCREASE

LIQUIDITY, WHILE KEEPING A CLAIM OPEN FOR METAL IN THE
FUTURE. TYPICALLY, CONTRACTS HAVE BEEN ROLLED OVER
BY A PROCESS KNOWN AS "LENDING" (SELLING OUT A MATURING
CONTRACT AND SIMULTANEOUSLY BUYING A NEW ONE). THROUGH
THIS PROCESS, COPPER FABRICATORS HAVE BEEN ABLE TO
KEEP INVENTORIES DOWN TO A BARE MINIMUM. PRODUCERS
AS WELL, WHO OTHERWISE WOULD HAVE HAD TO FOREGO EX-
CHANGE EARNINGS, HAVE BEEN ABLE TO MAINTAIN A HIGHER

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THAN OTHERWISE LEVEL OF EXPORTS.

6. THE COST TO COPPER FABRICATORS IS PROBABLY MINIMAL.
THEY SACRIFICE CONTANGO EARNINGS, BUT THE COST OF A
COPPER-SECURED LOAN WOULD PROBABLY BE HIGHER. ON THE
OTHER HAND, IT HAS BEEN ARGUED THAT PRODUCERS WOULD HAVE
BEEN BETTER OFF TO LEAVE THEIR COPPER IN THE GROUND
UNTIL THE COMBINATION OF SHORT SUPPLY AND RISING DEMAND
SHOULD RESULT IN A GENUINE BULL MARKET. TO A LIMITED

EXTENT, THIS IS WHAT CIPEC HAS BEEN ADVOCATING; HOWEVER, THE SCOPE FOR SUCH A POLICY, OF COURSE, IS LIMITED BY PRESENT FOREIGN EXCHANGE NEEDS OF THE PRODUCING COUNTRIES. MOREOVER, THE EFFICACY OF ANY EXPORT CONTROL SYSTEM WOULD SEEM QUESTIONABLE SO LONG AS THE LME WAREHOUSES ARE BULGING WITH COPPER, NOT TO MENTION LONG-TERM DELETERIOUS EFFECTS ON THE INDUSTRY AS A WHOLE.

7. ALL IN ALL, THE LME AND ITS WAREHOUSE SYSTEM UNTIL NOW SEEM TO HAVE HAD A MODERATING INFLUENCE ON THE LIMITED OFFICIAL USE

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MARKET. HAD THERE BEEN NO SUCH MECHANISM IN PLACE, PRODUCERS MIGHT WELL HAVE BEEN FACED WITH A DISASTROUS MARKET RATHER THAN A MODERATE-WEAK ONE. THE SYSTEM, IN SHORT, HAS OPERATED MUCH AS A GIGANTIC, BANK-FINANCED BUFFER STOCK, SUPPORTING PRICES (SO LONG AS CONFIDENCE REMAINED THAT COPPER'S DECLINE WAS ONLY TEMPORARY). THE OVERHANG EFFECT OF 500,000 TONS OF COPPER SHOULD HAVE A MODERATING INFLUENCE ON THE OTHER SIDE AS WELL WHEN DEMAND BEGINS TO PICK UP.

8. AS A FINAL NOTE, OBVIOUSLY, THIS CABLE ONLY SCRATCHES THE SURFACE OF A COMPLEX PROBLEM. POINTS NOT ADDRESSED INCLUDE THE STABILITY OF THE SYSTEM -- HOW MUCH LONGER CAN SUCH STOCK PILING GO ON IF AN UPTURN IN DEMAND IS DELAYED, WHO ARE THE LOSERS, AND TO WHAT EXTENT SHOULD THE LME BE TAKEN INTO ACCOUNT IN DEVELOPING WORLD COPPER POLICY.

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